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IN THE

Supreme Court of the United States

NO. 653

GAS RIDGE, INC.,
Petitioner,

SUBURBA
v.

RICULTURAL PROPERTIES, INC.,
Respondent.

PETITIO

S BRIEF TO RESPONDENT'S REPLY

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Respondent.

PETITIONER'S BRIEF TO RESPONDENT'S REPLY

To the Honorable Supreme Court of the United States:

I

First Assignment of Error

Respondent either misinterprets or misrepresents petitioner's position in relation to this question. The latter has not asserted that *W. T. Waggoner Estate* v. *Sigler Oil Company* (19 S. W. (2) 27 and *Garcia*

v. *King* (164 S. W. (2) 509) are in conflict. As conceded by respondent, *Waggoner* v. *Sigler* dealt with a situation where there was commercial production *at the end of the primary term*, whereas in *Garcia* v. *King* such quantum of production was lacking *when the fixed term ended.*

In the case at bar respondent neither denies nor questions the existence of paying oil or gas when the primary term ended on December 7, 1925. In fact, the record affirmatively indicates that the leased premises were commercially productive of oil and gas when the fixed period ended, in that by instrument dated May 24, 1924, the lessor *reduced* the royalties specified in the original lease (R 35), and agreed that, as thus modified, it should *continue* in full force and effect (petitioner's Ex. 17, pp. 61-62 of the Exhibit Appendix).

It is apparent, therefore, that the controlling factual difference between *Garcia* v. *King* on the one hand and the case at bar and *Waggoner* v. *Sigler* on the other is that in the former there was absent commercial production at the *end* of the primary term, wherefore, the necessity therefor having been implied, the estate *automatically* ceased to exist, whereas in *Waggoner* v. *Sigler* such term limitation upon the duration of the estate having been met, there was no other condition in the contract (as there is none in agreement here involved) upon which could be predicated an *automatic* ending of the lessee's estate. The only difference in the situation here in this respect and that obtaining in *Waggoner* v. *Sig-*

ler is that, assuming applicability of the term "paying quantities," neither by allegation nor proof does respondent furnish the basis for a determination that petitioner's estate automatically ceased to exist when the fixed period ended.

Respondent's confusion appears to result from its failure to distinguish between a limitation upon the duration of an estate and breach of a condition subsequent entitling the grantor to reentry. In the former no judicial latitude is permitted. When the period fixed for its duration has elapsed, or the precise condition limiting its life has occurred, the estate simply ceases to exist, whereas in a situation embodying the alleged breach of an express or implied condition the existence of which is of necessity factually uncertain, it will be treated as the violation of a condition subsequent in the nature of a covenant which, save in extraordinary circumstances, will not support a forfeiture.

This distinction is made unmistakably clear in *Waggoner* v. *Sigler*, where the court, following discussion of the difference in this respect between a "drill or pay" clause and an "unless" limitation, says further:

> "The words of the second and third clauses of limitation above mentioned, not only fail to make the duration of the granted estate depend upon *the degree of diligence* (the court's emphasis) in the continued exploration, development and *production* (emphasis added) of oil and gas on the land, after their discovery, but

> such words expressly negative the termination of the lessee's interests as long as either oil or gas was actually being produced from the land. The express provision of the third clause is that the lease shall remain in force, i. e., shall *not* terminate, *as long as* (the court's emphasis) either oil or gas is produced from the land by the lessee. We are asked to say, by judicial interpretation, that the lease shall terminate *before* (the court's emphasis) the cessation of production of oil or gas from the land by the lessee, if, by reasonable diligence, more oil or gas could have been found, produced or marketed. A court should never override by implication the intention of parties expressed in a binding writing. Freeport Sulphur Co. v. American Sulphur Royalty Co. (Tex. Sup.), 6 S. W. (2) 1043" (p. 30).

When the principles announced with such clarity in the Waggoner-Sigler case are considered in the light of the later decision of the Texas Supreme Court in *Watson* v. *Rochmill*, 155 S. W. (2) 783 (by Judge Alexander, who wrote the opinion in *Garcia* v. *King*), where it was unequivocally held that the lessee could have maintained his estate by operating the well for whatever oil it would produce, although unprofitably, the conclusion appears to be inescapable that a lease such as that involved here cannot be forfeited *after* the expiration of the primary term *so long as* oil or gas is being *produced* and marketed, as expressly provided by its duration clause.

Wherefore, petitioner respectfully reiterates its position that *Garcia* v. *King*, upon which respond-

ent and the Circuit Court almost exclusively rely, goes no further than to hold that a lease such as that there involved will *automatically* terminate if at the end of its expressly defined duration term there is an absence of paying production of oil or gas; but that, even though it might be held that the decision was not thus limited in its legal effect, the condition of "paying quantities" there implied could not be so treated here because of several material differences in the two contracts, clearly evidencing in the case at bar that the parties intended to say exactly what they did say, i. e., that the estate of the lessee would continue so long as oil or gas might be *produced* from the leased premises, either from the existing wells or those drilled in the future.

And in this connection, an obvious contradiction in terms and legal effect may be noted in respondent's trial complaint, the trial court's findings and conclusions and in the judgment, wherein it is charged, found, concluded and adjudged that the lease *automatically* terminated at some unspecified time *more* than five years before the trial. This was as close as respondent and the trial court were willing to fix the occurrence of the event which as a matter of law had the effect of *automatically* putting an end to a vested estate in lands. If neither respondent nor the trial court was prepared to say with any degree of certainty when such event occurred, the conclusion would appear to necessarily follow that such a breach, assumed arguendo, should not be accorded the dignity of an express or implied limitation upon the duration of the grant, but should

be held, if properly implied, to be a mere covenant.

Respondent suggests the automatic termination of a life estate upon the death of the life tenant, as pertinently illustrative of a limitation upon the duration of the life estate excluding the idea of forfeiture from (to) the residuaries. But this is begging the question, because in the case at bar there was no such or any limitation upon the duration of the estate granted save to *produce* oil or gas from the premises. However, in relation to an estate upon condition, assume a different situation from that suggested by respondent, more relevant to the facts here, where an estate was granted, to continue so long as the grantee might adequately support and maintain the children of a marriage. Such a limitation would not support a contested forfeiture, because, as stated by Chief Justice Stayton in *Benavides* v. *Hunt* (Tex. Sup.), 15 S. W. 399, "the use of all economy" would be too uncertain to recognize as a condition on which a forfeiture might rest, as "it would vary as much as the opinions of witnesses might vary on a matter of fact about which no fixed rule determines compliance or noncompliance"; and that "The authority to forfeit estates vested can not exist by reason of the existence or nonexistence of a state of facts not clearly defined," sound principles of law which were reaffirmed in the later case of *Decker* v. *Kirlicks* (Tex. Sup.), 216 S. W. 386.

The necessity for certainty in cases of this nature

is emphasized not only by obvious confusion in the minds of respondent and the trial court as to when the event occurred which served to automatically end the estate, but by the indecisiveness of respondent's witnesses as to whether it occurred at all, particularly in relation to the gas, evidenced by wide discrepancies in the testimony of respondent's witnesses LESLIE and BUSSA, the former testifying unequivocally that it cost very little to operate the gas wells (R 55-56) and the latter, based upon pure assumption, that it cost about, or not less than, three times as much to operate an oil well as it does a gas well (R 83).

And it may be noted further *that no witness in this case testified to any definable expense attributable to the production and marketing of the gas.* It appears to be respondent's position that this Court will assume, as did the District and Circuit Courts, that some arbitrary, undefined proportion of the expense incident to operating the twelve oil wells on the lease in controversy should be allocated to the gas wells, with no surer foundation than the guess of BUSSA that the proportion of expense should be fixed on the basis of about three to one for the oil wells over the gas wells; and the accountant WALKER'S conclusions (R 152, 153 and 154) that certain computations made by him correctly reflected the profit and loss status of the lease in controversy for the years 1941, 1942 and 1943, because the Federal Government in certain circumstances would accept such estimates in determining depletion allowables, which is a far cry from the

definite proof required by all of the Texas decisions as a prerequisite to forfeiture of a vested estate.

II

Second Assignment of Error

Respondent's rather facetious dismissal of Judge Sibley's dissent is not justified by the record. The devastating portion of the Judge's observation is not so much that "there is no fact finding that the six gas wells operate at a loss," but the concluding statement "*and the evidence does not show it.*" It may be of little consequence whether the trial court's finding that neither oil nor gas was produced in commercial quantities appears in the findings as such, or in the formal judgment, although ordinarily in a case tried by the court the judgment must find support in the findings of fact and conclusions of law. However, this distinction may be dismissed as smacking of technicality, and it is not petitioner's position that it should prevail in this case save upon the basis of applicable principles of law addressed to the established or conceded facts. But when the Judge in his dissent says that the evidence does not show that the six gas wells were operated at a loss, he is indubitably correct, evidenced by the following:

(a) Respondent's witness LESLIE testified unequivocally that the expense attached to operating

the gas wells was of no consequence, "just maintenance of lines, a few odds and ends" (R 56);

(b) Respondent produced no other witness who even professed to have any actual knowledge of the expense incident to operating the six gas wells situated on the premises;

(c) It is not disputed that for many years the said wells have been connected and regularly delivering gas to an established pipe line (which alone should dispose of the question of the production of gas in commercial quantities); and

(d) Respondent produced no witness who testified to any ascertainable or definable expense attached to the production and marketing of the gas on the lease in question (thus leaving the forfeiture of a vested estate to rest upon conjecture and assumption).

Evidently recognizing the necessity for countering Judge Sibley's conclusion that the evidence was deficient in this respect, respondent has resorted to the obviously desperate expedient of attempting to show that in the years 1934, 1935 and 1936, when *petitioner* produced nothing but gas, losses were sustained in the amounts stated, presumably from operations on all of its leases. But the difficulty with respondent's position here is that the claimed loss (which is not shown by the evidence, as will be pointed out) *occurred before respondent acquired title to the property on July* 8, 1937 (R 16; respond-

ent's Exhibit 18, at page 63 of the Exhibit Appendix), and before its alter ego, the Alamo National Bank, acquired title June 19, 1937, by a conveyance made subject to the lease here involved (R 124; respondent's Exhibit 10, at page 20).

Thus are we confronted with the truly remarkable idea that the forfeiture of a vested estate may be sustained because of the existence of alleged conditions occurring prior to the acquisition of title by the complainant whose mentor accepted the conveyance subject to the terms and conditions of the very lease which its "vehicle" later sought to destroy. Turning again to *W. T. Waggoner Estate* v. *Sigler Oil Co.* (19 S. W. (2) 27) and the many authorities there cited, the principle of law is too well settled to admit of cavil, that where forfeiture of a vested estate is sought based upon the alleged breach of a condition subsequent which does not expressly limit the duration of the estate granted, it must be shown that the grantor, by express act, took advantage of the breach by re-entry, or that which in law would be equivalent thereto (bottom page 31 of the opinion).

Not only does this record show no express act by respondent's predecessors looking to re-entry because of the alleged losses sustained in the years 1934, 1935 and 1936, but the bank president swears (in May 1944) that the Alamo National Bank had *controlled* the property, either through W. H. Kennon or respondent for fifteen years prior to the trial (R 161). Thus is it conceded that during said years,

1934, 1935 and 1936, the moving spirit in this equation took no action, nor did it direct the taking of any action, looking to re-entry for the alleged breach of the implied obligation to maintain the lease on commercial production of oil or gas. Not only that, but the evidence and findings show that after the filing of complainant's suit in the state court on November 8, 1941, it continued to accept oil and gas royalties until January, 1943, after which such royalties were regularly tendered and refused to the date of trial (R 181); and that the bank president had numerous conferences with petitioner's representatives both before and after the filing of suit by respondent, looking to the drilling of a deep test and the readjustment of the lease in controversy thereto (R 162-163).

Assume for purposes of the discussion that the implied requirement of oil or gas production in paying quantities is applicable to the contract here involved and that respondent has established that there was a failure to thus produce at some undefined time more than five years before and continuously to the date of trial, such clearly would and could not constitute a limitation upon the duration of the estate, but at most would amount to the breach of a condition subsequent, which "the lessor must, by express act, take advantage of by re-entry, or that which in law would be equivalent thereto" (*Waggoner* v. *Sigler*, 19 S. W. (2) 27 (p. 31). Yet respondent would have this Court hold with its contention that an alleged loss which occurred before it acquired the property would suffice as grounds for

cancellation in the absence of proof of re-entry by the then owner and under conditions where it is conceded that up to the time of the filing of the suit there had been no move by it or its predecessors looking to re-entry, much less the "express act" held to be necessary therefor.

And another significant fact may be noted in connection with respondent's reply to this assignment, where it is asserted that during the years 1934, 1935 and 1936, "*petitioner* produced nothing but gas—no oil whatever." Respondent evidently overlooks the fact that by express provision in the lease the right of assignment was given, in whole or in part, and that "the development obligations hereinabove provided for shall be deemed to have been complied with whether performed by lessee or any of its assigns." The record is completely silent as to the extent of any such development or production, although the grant shows upon its face that an undisclosed number of oil and gas wells was expressly included therein; and surely it is not respondent's position that the burden rested upon petitioner, to avoid forfeiture of its vested estate, to show that it had made no assignments of portions of the leased premises and that its assignees had not met the implied condition of production of oil in paying quantities.

Furthermore, inspection of petitioner's income tax returns for the years 1934, 1935 and 1936 (as well as its other income tax returns) will disclose that there are many items not properly chargeable to operating expense, as that term has been defined

in *Garcia* v. *King* (164 S. W. (2) 27), as will be shown herein later.

III

The Equities

This case not being one where the estate automatically terminated because of the occurrence of a definite and ascertainable express or implied condition upon which its duration was made to depend, it is clearly of equitable cognizance (7 Tex. Jur., Sec. 2, p. 884; *Cooley et al* v. *Buie et ux.* (Comm. Ap., opinion adopted Tex. Sup.) 291 S. W. 876). And while it is true that where an estate can be said to have automatically ceased to exist by the happening at a definitely ascertainable time of an express or implied condition limiting its duration, such is not the situation here because respondent's pleadings, the findings and conclusions and the judgment all disclose uncertainty as to when the condition implied in the case at bar came about. Wherefore, it is submitted, the case should have been disposed of by applying several pertinent equitable principles to the undisputed and conceded facts which would have denied to respondent sympathetic consideration of its plea.

Respondent Does Not Offer To Do Equity.

In its abandoned complaint respondent evidently felt that it was only fair and right that petitioner

should be permitted to retain its eighteen oil and gas wells, with the right of ingress and egress thereto, but subject to the canny provision that none of these could be deepened (evidently to deprive petitioner of even that limited access to the known tremendous reserves of oil and gas at a depth of 3600 feet). This initial generous impulse is shown at page 9 of the record. However, respondent evidently experienced a change of heart when it came to file its current complaint, under which it successfully confiscated not only petitioner's leasehold estate, but its eighteen oil and gas wells. There is nothing of good conscience in such an attitude, particularly where respondent knew when its original complaint was filed in the state court that petitioner had obtained permits from the Texas Railroad Commission to drill fifteen wells for oil or gas and had completed seven of them when the war emergency and the rules and regulations of the Federal Government incident thereto caused a suspension of further drilling (such further comment as may be desired).

Respondent Does Not Come Into Court With Clean Hands.

It was petitioner's position before the trial court, and is now, that when the paralyzing effect upon all commercial and industrial activities struck this country with the impact of an unexpected blow in the face, any court, particularly a court of equity, should have given due consideration to the facts and circum-

stances shown by the record which piled handicap upon handicap against the full operation of this property, particularly as to the oil. But respondent promptly interposed technical, legal objections (which were not even good as legal propositions, as will hereinafter be shown) to according petitioner any equitable consideration, although respondent induced the trial court to find that petitioner's motive in attempting to maintain the lease on production was ulterior (Findings, paragraph 9, R. 180). In fact, the findings throughout are manifestly argumentative, evidenced by paragraphs 5, 6, 7, 8, 9, 10, 11, 12 and 13) R. 178, 179, 180 and 181, as though, for instance, the fact that petitioner has no other assets than its several leases in this field can be relevant to the construction of a written contract entered into twenty-five years ago! No doubt the Alamo National Bank has ample assets (which presumably could not be utilized in oil and gas wildcatting), but it is quite certain from this record that respondent was in a worse fix as to assets than was petitioner, because the only asset it apparently owned (the fee title) was encumbered with a debt of $95,000.00. So that, if this case were to be decided upon a balancing of assets, respondent does not come out with such flying colors. At least, petitioner was possessed of sufficient resources to embark upon a campaign to drill fifteen wells, and it is not to be assumed that such could have been drilled, completed, equipped and placed on production at a cost of less than $2,000 each. In any event respondent does not show that it was capable of drilling the

deep test without utilizing the acreage in this lease therefor.

Respondent Says that the Term Provision of the Lease Creates a Determinable Fee but (a) thereby Assumes to be True that which Is in Dispute that the Word "Production" Means "Production in Paying Quantities" but (b) Fails to Give the Date when the Event Happened that Terminated the Lease.

(a) The lease provides "said lease to continue for the term of five years from this date and as long thereafter as oil or gas is produced from said lease premises by the lessee, its successors or assigns." The language is as plain as words can express. At no time has respondent or the District Court or the Court of Appeals pointed out any ambiguity in that language. There is nothing therefore in the Record or in the face of the clause itself that could in any way warrant any court to rewrite the phrase and stick on to it a qualifying phrase which drastically changes the meaning of the term provision. That is not denied either, namely, that it changes the meaning of the clause. This places the decision of the Court of Appeals in direct conflict with Texas authorities. 10 Texas Jr. 279, with the many Texas cases therein cited. Also see *Magnolia Petroleum Co.* v. *Cornellae* (Com. App.) 11 S. W. (2d) 158; *Southern Gas & Gasoline Eng. Co.* v. *Richardson* (Com. App.) 216 S. W. 158.

(b) Neither the respondent, the District Court, nor the Court of Appeals states the date within a

reasonable time when paying production ceased, if it did, which defendant specifically denies.

Respondent, in its reply brief, says "The lessee's legal title is determinable. When paying production ceases the legal estate dies by virtue of the limitation imposed upon it in the term clause." Reply to Petition for Certiorari, page 4.

The District Court, on the question as to when production "in paying quanties" ceased, found as follows:

Findings of Fact:

> "1. The defendant's wells on this lease ceased to be physically capable of producing oil and gas in paying and commercial quantities *in, or before, the year* 1934, etc." Tr. R. 180.

Conclusions of Law:

> "1. The mineral leasehold estate automatically terminated and expired by virtue of its own terms, provisions and limitations, upon the cessation of production in paying quantities which occurred *more than five years ago.*" Tr. R. 182.

If the respondent, the District Court, and the Court of Appeals do not know when the event occurred when petitioner's lease expired, how can this Court or anyone else speculate as to such date? Respondent did not acquire title to the land until June,

1937 and from that date until two years and three months after petitioner filed its suit it continued to accept the oil and gas royalties, that is, the monthly checks for the same.

The Foregoing Findings of the District Court are too Highly Inconsistent, Self-Destructive and Vague to be the Foundation of a Judgment.

The findings are too vague and inconsistent and self-destructive to justify any court's decreeing the taking of petitioner's property and giving it to respondent. They cover a range of one to fifteen or even twenty years within which the termination of the lease occurred, according to respondent's theory. Of course petitioner specifically denies that it has ever happened. Due process of law dictates that where a judgment of such consequence as this one entails, the date when the lease should have ended should certainly have been determined to a reasonable certainty, that is, within a few days. The very fact that respondent and the two courts have been unable to find anything in the record which would warrant them to name a date is sufficient proof that plaintiff's case has no merit.

Waiver and Estoppel Apply to a Determinable Fee as Well as to Any Other Claimed Right.

The Court of Appeals said that plaintiff's acceptance of royalties does not "operate as a waiver or an

estoppel to assert the claim that the rights of the taker as lessee have terminated."

That is error and is directly in conflict with the decisions of the courts of Texas. According to the District Court's Finding of Fact. No. 11, (Tr. R. 180) for more than ten years plaintiff and his predecessors have been taking their monthly checks, saying nothing and never complaining and plaintiff even took his royalty checks for two years and three months after suit was filed and predecessors and plaintiff stood by watching defendant and predecessors spending their money and drilling wells and never protested. Each one of those acts, accepting the monthly check and watching the defendant spend its money in drilling additional wells, meant that lessor considered that the lease was still in existence or that it constituted a mutual agreement between the two parties for the extension of the lease, assuming that the lease term was as contended for by the plaintiff, which petitioner specifically denies. *Mitchell* v. *Sims*, 63 S. W. 2d, 371 (Com. App.); *Guerra* v. *Chancellor* (Tex. Civ. App.) 103 S. W. 2d 775. See pages 780 for opinion on Motion for Rehearing.

Plaintiff did not commence its suit until the defendant had drilled its seventh producing well. In other words, it stood by and saw defendant spend its money in drilling additional wells when the plaintiff claimed that the lease had expired many years before plaintiff acquired the property. That consti-

tuted a fraud perpetrated upon the defendant. Under the circumstances, equity and ordinary justice required plaintiff to speak.

> "Waiver is the relinquishment of some right by word or conduct, while estoppel arises from the perpetration of a wrong, a fraud which has misled another to his injury and from which justice and equity would prevent him from receiving profit or benefit." 43 Tex. Jur. 893. See cases cited.

Respondent, on Page 6 of Its Reply to the Petition for Certiorari, Erroneously States "During those Three Years in which It Produced Gas Only, Petitioner, by its Own Admissions, Sustained Losses in its Current Operations from Gas Production Only."

The respondent, in its reply brief, page 6, says: "During those three years in which it produced gas only, petitioner, by its own admissions, sustained losses in its current operations from gas production only." The Record is wholly barren of any such admission made during the trial of the case in the District Court. In order to answer this charge, it will be necessary to go somewhat into detail as to what took place in the trial court.

At the close of the trial in the District Court, (Tr. R. 136-148) when petitioner, who was the defendant in that court, had rested its case. Petitioner, the plaintiff, introduced ten verified Wisconsin state income tax reports, including the years 1934-1943, in-

clusive. These were highly inadmissible without deleting many large items of expense which are proper deductions in an income tax report but do not come within the definition of "operating cost" as applied to the term used in connection with the issue involved in this case, as defined by the Supreme Court of Texas in the case of *Garcia* v. *King*, supra, which is:

> "It has been generally held that 'paying quantities,' when used in this connection, means paying quantities to the lessee. If a well pays a profit, even small, over operating expenses, it produces in paying quantities, though it may never repay its costs, and the enterprise as a whole may prove unprofitable. Ordinarily, the phrase is to be construed with reference to the operator, and by his judgment when exercised in good faith."

According to this, operating costs are limited to two things; the cost of bringing the oil from the producing structure to the surface and that of marketing it. Inasmuch as the Gas Ridge Field is not connected with an oil pipeline, the refinery trucks the oil from the field to the refinery, making a small charge of 10c per barrel therefor. As to gas, the pipeline company buying the gas has its line not only to the field, but to the meter on each lease. Consequently, as to gas, there is no marketing cost and as it lifts itself from the producing structure to the surface, there is no pumping cost. The gathering lines from the well to the meter were put in years ago and are small pipelines extending only a few yards. Thus there is no operating cost as to gas.

From the definition of operating costs as given by the Supreme Court of Texas, as applied to the production of oil and gas, they represent something vastly different and much more limited than allowable deduction expense in income tax reports, state and federal. Consequently, unless the income tax reports are thoroughly deleted of both the income and expense deductions, they are not admissible. Plaintiff used the income tax reports as they are, with no attempt made to analyze them, according to the definition of the Supreme Court of Texas just quoted. Defendant did analyze them and presented such analysis to the District Court and the Court of Appeals in briefs and oral argument.

Besides containing many items in large amounts which are proper deductions in an income tax report but not operating costs according to the Supreme Court of Texas, there are two other special items peculiar to oil production which must be deleted before the income tax reports are admissible; first in that in about 1925, lessor, the Land Company, was given the right by lessee, the Development Company, to drill on the lease under the condition that if production was had, then lessor and lessee were to share equally in the leasehold interest income after all expense was paid. Under this agreement, which was afterwards substantially put in writing, defendant's Exhibits 16½ and 17, the Land Company drilled five producing gas wells, Numbers 11, 12, 13, 14, and 15, some of which are still producing. This income which the Land Company re-

ceived from the ½ leasehold interest is called "divisional interest." This is therefore income from the leasehold estate and must be added to the income which defendant received in order to ascertain the income from the full leasehold interest.

The 1/8 interest income from the land, the landowner's royalty, must be deducted from the total production from the wells in figuring operating costs. The defendant, in making out its income tax report for the state of Wisconsin, therefore, had the right to deduct from the total production in dollars both the divisional leasehold income which was paid to the Land Company by defendant and the royalty in order to find its true income. Therefore, the income listed under royalty in the income tax report, consisting of both divisional interest and royalty, is correct as to the income tax report but gross error as to the operating costs because divisional interest paid to the Land Company is not operating cost. Consequently, in figuring operating costs from the income tax report, there are two corrections that must be made. The first is to take the divisional interest income out of the royalty income and second, put it into the leasehold income. That divisional interest of the Land Company was not income to the defendant but it is income to the leasehold estate. Addendum "I" gives the amount of the divisional interest income which was in the first place added to royalty income and in the second place taken out of leasehold income—double error.

Second, the income tax reports for 1934, '35, '36,

and the greater part of 1937 of oil production income is not contained in the income tax reports. During those years and for a number of years prior thereto, the oil wells on the Hamilton-Swain lease were owned and operated by A. W. Pausky. The latter part of 1937 defendant purchased these wells from A. W. Pausky and commenced to operate them in October, 1937. Consequently, in order to obtain the income from the whole leasehold estate, both oil as well as gas, it was necessary that Pausky's oil income during those years, amounting to about $10,000.00, must be added to what income defendant reported in its income tax in order to obtain the true leasehold income. See Addendum "II."

The foregoing are income corrections which must be made in the income tax reports if those reports are to be used at all in this case.

Likewise, there are in each income tax report expense items equally not includible under operating costs, as defined by the Supreme Court of Texas, totaling considerably in excess of $10,000. As an example of inclusion of items of expense proper as to an income tax report but wholly incorrect for items making up operating costs of production on an oil and gas lease is the following for the year 1939.

Directors' fee	$ 120.00
Legal and Traveling expenses	660.00
Accounting services	160.00
Interest expense	808.67

Franchise tax	21.00
Capital stock tax	9.00
Depreciation	678.71
And losses on leases and options (failure to exercise options)	5,400.73
Total	$8,508.32

The items of expense as to the other years' income tax reports, not proper operating costs, are listed in Addendum III.

It is immaterial as to operating costs, whether the company is a corporation or is owned by individuals or a partnership. Thus directors' fees and capital stock tax are not operating costs as defined by the Supreme Court of Texas. Likewise, traveling expense between Milwaukee, Wisconsin, and San Antonio, Texas, and legal fees have nothing to do with the cost of lifting the oil from the structure to the surface and marketing it. The same is true as to the other items. In 1937, the defendant was obliged to buy the fee of the Voges lease. The lessor had given a mortgage on the property which pre-dated the lease and the mortgagee was obliged to foreclose and did institute foreclosure proceedings against the lessor and defendant, lessee. The defendant was then forced to buy this land in order to save its lease. In buying it, the defendant put a mortgage lien of around $6,000 on the land. Every year defendant was obliged to pay interest, taxes and also a small amount on the principal. Depreciation is merely a paper deduction and certainly losses on leases and

options which had nothing whatsoever to do with the lease in question in this suit are obviously not operating costs of the Hamilton-Swain lease.

Addendum "II" gives the total production of both oil and gas, less royalties and operating costs, and income in excess of royalties and operating costs, as shown by the income tax reports when proper deletions are made.

Addendum "IV" gives the total gas production on all leases during the period from January 1, 1934, to and including May 31, 1944. Addendum "V" gives the gas production on the Hamilton-Swain lease during the same period. Addendum "VI" gives the oil production on the Hamilton-Swain lease during the same period and Addendum "VII" gives the net income from oil and gas production on the Hamilton-Swain lease from January 1, 1934 to December 31, 1943, first, when the operating costs of all leases are broken down to the Hamilton-Swain tract on a well basis and second on an income basis.

Respondent has never in any of its briefs taken issue with petitioner's analysis of the income tax report. It is submitted that respondent's use of the word "admissions" on pages 5 and 6 of its Reply Brief to the petition is not only unwarranted but highly misleading. The Wisconsin income tax reports of petitioner for the years 1934-'43 inclusive are to be found on pages 22-38 and are plaintiff's Exhibits 12-21 inclusive. See Exhibit Appendix. A

mere casual inspection will quickly evidence that each report contains many large items which must be deleted if the reports are to be admitted in evidence because they are not included in the expression "operating costs" as defined by the Supreme Court of Texas.

Again on page 6 of the Reply to the Petition of Certiorari of Respondent, at the end of the first paragraph, it is stated that petitioner "sustained losses in its current operations from gas production only, of $1,010.83 in 1934, $1,090.25 in 1935 and $413.32 in 1936. In the next paragraph it is stated "that the modest salary paid this *one field* employee, William Leslie, continuously exceeded petitioner's entire income from all its gas production. For example:

'Exhibit Appendix' Page	Year	Leslie's Salary	Total Gas Income
38	1943	$2070.00	$1,222.92
36	1942	1920.00	432.78
34	1941	1620.00	1,182.76

Counsel for respondent says "paid this *one* field employee," implying that there was more than one field employee when counsel for respondent well knew that there was no other field employee than William Leslie.

The foregoing quotation also wrongfully implies that William Leslie was employed by the defendant,

Gas Ridge, Inc., during the years 1934, '35, and '36. Miller knows different. Leslie was examined as an adverse witness by plaintiff's attorney, Mr. Miller, as follows:

> Question. "How long have you been out there in that work?"
>
> Answer. "Since January, 1940." Tr. R. 50.

There are seven producing leases in the Gas Ridge field owned by petitioner, the Hamilton-Swain being only one of them. They are operated on the unit system, that is, they have one power plant for pumping the oil and *one* employee taking care of the pumping equipment, pumping the oil each day. Consequently, all operating costs must not be charged to the Hamilton-Swain lease as the statement of respondent in his brief on pages 5 and 6 implies, but must be allocated among the various leases.

In 1934, '35, and '36, petitioner, the defendant, merely operated the gas production. During those years A. W. Pausky owned and operated the oil wells under the lease, the subject of cancellation. The total production of oil and gas on all leases minus royalties and operating costs in 1934 was $5,281.95, in 1935, $5,465.02, 1936, $4,774.45. See Addendum II. Both the gas and oil were produced under the same leases. The two productions—oil and gas—must be taken together in determining whether or not the leases were operated at some profit. Addendum IV also gives the total production of oil and gas on all leases for the ten year period and income

in excess of operating costs and royalties. Addendum VII gives the net income of both oil and gas minus royalties and expenses on the Hamilton-Swain lease, the expenses being allocated both on the basis of the number of oil wells and also on the income basis.

The Circuit Court of Appeals passed over this issue without a comment. Defendant had the constitutional right to have had the Court of Appeals pass upon the questions of whether the items of expense listed in the income tax report which defendant says are not operating costs, as tested by the definition of "operating costs" as given by the Supreme Court of Texas are not operating costs. It was the duty of the Court of Appeals to have made a judicial determination of the same. The failure of that Court to pass upon those questions has resulted in taking defendant's property and giving it to plaintiff in violation of the Due Process Clause of the Constitution of the United States. In this failure of said Court to pass upo nthe question of whether defendant's analysis of the income tax reports was erroneous or correct in whole or in part, it has so far departed from the accepted and usual course of judicial proceedings and so far sanctioned a departure by the District Court as to call for the exercise of this Court's power of supervision.

The Burden of Proof in this Case Was Upon the Respondent, the Plaintiff, in the District Court.

Persky v. *First National Bank of Vernon*, 117 S. W. 2d, 861.

"Syllabus. The burden of showing that an oil well is not producing in paying quantities, so as to authorize cancellation of the lease, is on the party seeking cancellation."

"The records show the gross income from the well was more than $50 per month. The appellant says that his total expense involved in making that revenue has not been more than $50 any month since he purchased the lease. The appellee does not show any other expenses incurred by the appellant, and the burden in this respect is upon the appellee."

The War Generally and the War Directives Issued by the President and the War Board Greatly Affected Production of Oil. However, the District Court Held and Its Finding Was Upheld by the Court of Appeals that inasmuch as the Lease Contained "No Saving Clause," It Could Not be Pleaded as a Defense.

Early in 1941, the defendant secured 15 permits to drill shallow oil wells on the Hamilton-Swain tract. The drilling of these shallow wells was commenced before this suit was filed. In fact, 6 of these wells had been completed and were producers by the time defendant had been served with the citation and complaints. While drilling the 7th well in December, 1941, drilling was stopped by order of the OPA but defendant was allowed to complete the 7th well. Thus the defendant was stopped from carrying out its program of drilling a number of shallow producing oil wells, by virtue of the war exigencies and regulations.

The oil production on Gas Ridge has been continued for about 20 years. The amount produced was never enough to warrant the building of a pipe line to a refinery. Thus the oil was picked up by a loca lrefinery by its trucks. According to the testimony of the refinery's manager, Mr. Slimp, defendant suffered through the war not only its own griefs but also those of the refinery in its transporting and refining of the oil. Refinery's trucks broke down, repair parts could not be obtained, repairmen had gone to the war factories for more pay, new trucks could not be purchased, nor could secondhand ones be picked up. Transcript of Record, 121. The same was true as to repairs in the refinery. Sometimes the breaking of a small gadget would stop the refining process for a long time because it could not be replaced by the supply houses in San Antonio. When the refinery trucks could not transport the oil because of the unavailability of trucks or because the refinery ceased refining the oil, production of oil on the lease must stop.

Thus the stripper well subsidy on oil production was pay not merely for future production but for what their owners had before suffered from the directives of the War Department and other exigencies of the war. The case was tried in the District Court on May 17 and 18, 1894. The Court took the case under advisement and did not render its decision until October 4, 1944.

On or about July 12, 1944, the OPA promulgated a regulation providing for a subsidy for stripper oil

wells. This regulation specifically provided that any and all oil produced on Gas Ridge, Bexar County, Texas, was entitled to a subsidy to be paid by the Government of 35c per barrel, commencing with August 1, 1944. On or about September 1, defendant filed a motion to re-open the case for the purpose of introducing these regulations and showing their effect upon the income arising therefrom. Tr. R. 166-175.

The 35c subsidy per barrel of oil produced is all net income. The fact that the purchaser of the oil pays this 35c per barrel in addition to what he paid before and is being reimbursed for this 35c per barrel extra pay by the Government does not add to the taxes of the producer nor does it increase the amount of the operating costs. The 35c per barrel is therefore a net gain and a very substantial one.

It is a familiar doctrine that an appeal in an equity suit opens up inquiry as to the time of the ultimate decision.

In the recent case of *Public Utilities Commission* v. *United Fuel Co.*, 317 U. S. 456, 466, this court said:

> " . . . It is the case that is here now that must be decided, and it must be decided on the circumstances that exist now. Cf. Vandenbark v. Owens, Illinois Co., 311 U. S. 538, 542, 543, and cases there recited."

The District Court denied the motion of the defendant to re-open the case. In its Conclusions of Law No. 4, Tr. R. 182, it held that the defendant was not entitled to the foregoing war considerations, exigencies, and financial loss due to war directives because the lease "contains no saving clause." This, by silence, was affirmed by the Circuit Court of Appeals. The result of it all is that defendant's property has been taken through the decision of the District Court which is in direct conflict with the decision of this Court, *East N. Y. Savings Bank* v. *Hahn, et al*, decided November 5, this year. 90 L. Ed p. 9.

> "The formal mode of reasoning by means of which this 'protective power of the State,' 290 U. S. at 440, 78 L. Ed. 430, 54 S. Ct. 231, 88 ALR 1481, is acknowledged is of little moment. It may be treated as an implied condition of every contract and, as such, as much part of the contract as though it were written into it; whereby the State's exercise of its power enforces, and does not impair, a contract."

This principle is equally applicable and commanding when "the protective power" of the Federal Government is involved.

When the Court of Appeals Says "Production" Means "in Paying Quantities" It Denies Petitioner Its Constitutional Right of Contract.

The term clause in the lease says: " . . . for the term of five years from this date and as long there-

after as oil or gas is produced from said premises by lessee, its successors or assigns, etc." That language speaks for itself. There is no vague word or phrase in it and it is therefore unambiguous. At no time has the respondent and at no time did the District Court or the Court of Appeals point out any ambiguity in that language nor did it make any claim to that effect at any time. The Court of Appeals was therefore powerless to add a limiting phrase to a word of definite meaning. To attempt to do so would be an act of judicial usurpation.

> "The law leaves the contract just where the parties themselves have put it, and the courts will enforce it as made, without regard to questions as to whether the parties contract wisely or foolishly, or as to whether, in the light of subsequent events, a hardship may be worked.
>
> "Accordingly, the courts have often said that they cannot make a new contract for the parties nor add to, modify, vary, or change in any particular the contract as made, . . . " 10 Tex. Jur,, 279. See the many cases cited in the footnotes.

The phrase "in paying quantities" is used in this lease for the purpose of measuring the amount of production but in reference to something different than defining the term of the lease, namely:

> "The lessee agrees to commence actual drilling upon said property of an oil or gas well on or before Two Hundred Twenty days from date hereof and to complete same with reasonable diligence and dispatch to a depth of not less than

> Twelve Hundred feet unless oil or gas *in paying quantities* be found by lessee at a lesser depth," etc. Petition for Certiorari, p. 43.

The foregoing use of the phrase "in paying quantities" in the same instrument forbids any court to say that the word "production" in the term clause means "production in paying quantities."

The term clause in the lease as written is not prohibited by statute or forbidden by public policy. Neither the respondent nor the District Court nor the Circuit Court of Appeals has at any time made any claim to the contrary. Therefore, the decision of the Court of Appeals denies petitioner the right to make a contract which provides for an extension of the lease beyond the primary term for a period "as long thereafter as oil or gas is produced."

The right to make a contract in relation to one's own business is a part of the liberties protected by the Due Process Clause of the Fifth and Fourteenth Amendments of the Constitution of the United States. *Lochner* v. *New York*, 198 U. S., 53; *Coppage* v. *Kansas*, 236 U. S. 1; *Chicago, etc. R. Co.* v. *McGuire*, 219 U. S. 549.

> "In the absence of some positive law to the contrary, the right of contract is a necessary incident to the right to own and hold property. The liberty to make a contract for a lawful purpose is a *natural* right which is beyond the power of government to take from a citizen." 10 Tex. Jur. 16, citing St. Louis R. R. Co. v. Book-

er (Tex. Civ. App.) 5 S. W. (2d) 856, Certiorari denied. 279 U. S. 852.

The only way that this constitutional issue can be avoided in this case is as hereinbefore contended or by finding that lessor and lessee, when they executed the lease, intended exactly what the language in each instance expressed and inasmuch as in the case of *Garcia* v. *King*, the phrase "in paying quantities" does not appear in the lease involved, therefore, that case cannot be decisive of the case at bar. As there is no dispute in the case before this Court and as there has always been and still is both oil and gas production, the lease is still in full force.

The Decision of the Court of Appeals that Plaintiff Was an Innocent Purchaser is Wholly Unsupported by the Documentary Evidence.

The Court of Appeals says: "Complainant acquired its title to this land from E. C. Tarrant . . . without notice, actual or constructive, of the existence of the unrecorded document introduced in evidence as its Exhibits 14, 15, 16, and 16½. This is error, as we shall see immediately.

The lease in question in this case was executed on December 7, 1920, by Hamilton Land & Development Company, sometimes referred to as the Land Company, lessor, with the San Antonio Oil & Natural Gas Company as lessee. It was recorded on December 9, 1920 in Volume 619 on pages 470-572 of the Deed Records of Bexar County, Texas. W. H. Kennon

was at that time the secretary of the lessor corporation and attested the signature of its president, V. E. Hamilton.

Plaintiff did not acquire the fee title until June, 1937, when this lease was still outstanding and in full force. At that time, W. H. Kennon was the president of the plaintiff corporation. Shortly after December 7, 1920, the San Antonio Oil & Natural Gas Company assigned its lease to the Gas Ridge Development Company, sometimes referred to as the Development Company.

The plaintiff not only acquired lessor's interest in the Hamilton-Swain tract which is covered by the lease but also acquired an interest in the leasehold estate held by the Development Company in the following manner. On August 26, 1922, the Development Company, by written contract, conveyed certain drilling rights to one M. M. Sweetman who, in the same contract, assumed certain drilling obligations. This instrument, Defendant's Exhibit 14, was recorded in the Bexar County Deed Records on August 28, 1922, in Volume 682, page 552. Plaintiff acquired those drilling rights and assumed the drilling obligations through the following instruments:

Assign. Sweetman to Southern Nat. Gas Co. Jan. 10, '35, Recorded in Vol. 1459, p. 381.

United Gas Pub. Service Co., Assignment Union Producing Co., Sept. 25, 1937, Recorded Vol. 1607, p. 488.

Union Producing Company to Suburban Agricultural Properties, Inc., Sept. 30, '42.

Thus this petitioner acquired and still owns drilling rights of M. M. Sweetman on its own land.

The plaintiff, that is, respondent, also acquired drilling rights and drilling obligations from the Hamilton Land & Development Company who, in turn, had acquired such rights and drilling obligations from the Gas Ridge Development Company carved out of the latter's leasehold estate.

In 1925, some kind of an arrangement or contract must have been entered into between the Land Company and the Development Company for the joint drilling of five gas wells in which each party agreed to pay one-half of the cost of drilling and equipping the wells and each was to receive one-half of the net profit. During that year those five wells were drilled as in defendant's Exhibit "A," pages 3-12, the ½ divisional interest in the leasehold profits as to those wells were paid by the Development Company to the Land Company. See Addendum "I."

In January, 1937, a written contract was made and entered into by and between the Land Company and the Development Company similar to the arrangement whereby the five gas wells were drilled. Defendant's Exhibit 16½, Exhibit Appendix, page 59. See Addendum "VIII."

True, this instrument never was recorded but it

is referred to and its main provisions were incorporated in another instrument dated March 30, 1932 entered into between the Hamilton Land & Development Company by W. H. Kennon, president, and the American Gas Company and which was recorded in Vol. 1301, pp. 137-139, Bexar County Deed Records, Texas on April 1, 1932. See Addendum "IX." This was five years before respondent acquired its property in June, 1937. This instrument is defendant's Exhibit 17 and it is found in Exhibit Appendix, p. 61. One glance at these two instruments will show that the latter not only incorporates practically all of the former, but relates the joint drilling of the five gas wells, 11, 12, 13, 14 and 15 of the Hamilton-Swain lease. On June 28, 1937, when the Suburban Agricultural Properties acquired the Hamilton-Swain tract from the Alamo National Bank, the president of the Suburban Agricultural Properties, Inc., was W. H. Kennon who was secretary of the Land Company when it executed its lease to the San Antonio Natural Gas Company on December 7, 1920 and who was president of the Hamilton Land & Development Company when that company made its contract with the American Gas Company on March 30, 1932, just described.

Furthermore, on the same day on which plaintiff acquired the fee title to the Hamilton-Swain tract on June 28, 1937, the plaintiff by its president, W. H. Kennon, executed a deed of trust to S. J. Weyel, Jr., trustee, with the Alamo National Bank as beneficiary, to secure the payment of a promissory note in

excess of $95,000 made payable to the Alamo National Bank.

Thus Suburban Agricultural Properties not only had constructive but actual knowledge of that one unrecorded instrument, Defendant's Exhibit 16½, and of its contents.

The Court of Appeals says that plaintiff acquired good title through E. C. Tarrant. This is without any foundation. On October 31, 1928, the Hamilton Land & Development Company gave its deed of trust to Gus J. Groos for the benefit of E. C. Tarrant as beneficiary, covering the Hamilton-Swain tract, to secure the promissory note for $20,000. Tr. R. p. 123. The Hamilton-Swain lease thus predated the deed of trust by nearly eight years and the Sweetman contract which was recorded August 8, 1922, predated the deed of trust by six years.

On June 19, 1937, by special warranty deed, E. C. Tarrant, who had acquired the property of the Hamilton-Swain tract by foreclosure of the trust deed, conveyed it to the Alamo National Bank, the special warranty being "This conveyance is made subject to any and all outstanding oil, gas, and mineral leases and assignments thereof covering and affecting the real estate and premises hereinabove described and hereby conveyed." This was nine days before the Alamo National Bank conveyed the same property to the Suburban Agricultural Properties, Inc. This instrument (Tarrant to the Alamo National Bank was recorded in the Deed Records of

Bexar County on June 24, 1937. The instrument executed by the Alamo National Bank to the suburban Agricultural Properties, Inc., was also a special warranty deed, as follows:

> "To Have and To Hold, etc., Warrant and Forever Defend, etc., by, through or under grantor herein."

Any knowledge possessed by an officer of a corporation, as to matters within the scope of his authority, while he occupied such relation, is notice to the corporation, whenever it may have been acquired. *Waggoner* v. *Herring-Showers Lbr. Co.*, 40 S. W. (2d) 1, (Sup. Ct.).

> " . . . The corporation is charged with notice when its officers have knowledge of facts that would put a reasonable person on inquiry when reasonable inquiry would reveal the information. . . . " Hildebrand, Tex. Corp. Vol. 2, p. 650.

The Agreement between the Land Company and the Development Company Just Discussed, whereby Their Relationship as Lessor and Lessee was Modified, Created a Co-Tenancy as to the Leasehold Estate and a Joint Venture in the Development and Operation of the Lease whereby the Right of Action which Plaintiff Has, If Any, Would be Partitioned.

The Court of Appeals says that appellant, by virtue of certain contracts made between appellee's and appellant's predecessors, claimed a change of

"lessee's title from a determinable to an absolute fee." No such claim was made and there is nothing in the record to substantiate it. The Court of Appeals used that as a basis for its decision on this question. The only title which appellant ever claimed it received was by virtue of the oil and gas lease, the subject of this litigation, which is still in force, as appellant contends. In 1925, the Land Company and the Development Company entered into an agreement which, so far as is known now, was oral, whereby lessor was given the right to drill for oil or gas on the lease and in which agreement lessee was released from the obligation of developing the lease, each party agreeing to pay one-half of the development costs and each to receive one-half of the net income therefrom. Five producing gas wells were drilled that year, some of which are still producing. Subsequently thereto, in January, 1927, a written instrument was executed between the two parties which substantially embodied the foregoing provision. This instrument is Defendant's Exhibit 16½ to be found in the Exhibit Appendix, pages 59-60. The material parts of this Exhibit are to be found in Addendum VIII.

This contract whereby both lessor and lessee were given the right to drill is more or less an anomaly in the oil production business.

The foregoing agreement created a co-tenancy in the drilling rights in the leasehold estate of the defendant.

> "The estate (of a co-tenancy) may consist of any character of property subject to individual ownership, and the tenants may embrace any and all persons, whether natural or artificial, capable of owning such property." 11 Tex. Jur. 415, citing Broom v. Pearson 98 Tex. 469, 85 S. W. 790, 86 S. W. 723.

Plaintiff, in its first amended complaint, paragraph 14, pleads as follows:

> "Partition. If the lease hereinabove referred to has been maintained in full force and effect, which is not admitted, but denied, then and in that event only, this complainant alleges that it, the complainant, under and by virtue of the conveyances, contracts, and judgment enumerated in the preceeding paragraph, is the co-owner with defendant of said lease; that complainant and defendant, as tenants in common, are the sole owners of said lease and all rights thereunder; that the rights, titles and interests in the leasehold estate of this complainant demands a partition of said estate between the defendant and the complainant." Tr. R. 13.

The foregoing was an executed contract. The divisional interest of the leasehold estate income since and commencing with 1925 is to be found in Addendum No. I. That is what the plaintiff and its predecessors for many years have received.

Plaintiff as successor to the Land Company now has the same right of drilling which the Land Company had and exercised.

The right of action, if any, that plaintiff may have is for partition of the drilling rights under the foregoing contract. Apparently, plaintiff's plan is to dispossess the defendant and then drill, so as to cut off defendant's right.

A Public Interest of Inestimable Value is Involved.

The Public, the third party, is involved greatly because the production of oil and gas at all times is something in which the Public has a very vital interest. Therefore, there must not be any waste of natural resources. Waste, while it includes unnecessary blowing of oil and gas into the air, which is only a very small item, includes the loss of natural gas and oil underneath the surface of the earth and one of the ways of wasting natural resources in detriment to the public interest consists of failing to take out all the natural gas and oil that can be recovered.

Inspect the Addendi following this Answer to respondent's Reply Brief. The decision of the Court of Appeals in effect says that oil and gas should never have been produced, because the Finding of Fact, No. 11, Tr. R. 180, of the District Court says that "defendant's wells on this lease ceased to be physically capable of producing oil and gas in paying and commercial quantities in, or before, the year 1934," yet the OPA, in July, 1944, promulgated the stripper well subsidy in which the oil production on Gas Ridge was given a subsidy of 35c

per barrel. Tr. R. 170. That is, this field was mentioned specifically as entitled to 35c per barrel subsidy.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may issue in this cause to the United States Circut Court of Appeals for the Fifth Circuit.

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FAGAN DICKSON,
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ADDENDUM I

Income Received by Lessor Land Company, Respondent's Predecessor from Divisional Interest in the Leasehold Estate of an Undivided One-Half Interest ever since 1925 in Addition to Lessor's One-Eighth Landowner's Royalty.

Early in 1925 lessor, the Land Company, was given the right by lessee, the Gas Ridge Development Company, to drill on the Hamilton-Swain lease on the condition that if production resulted therefrom, then each company was to pay one-half of the cost of the drilling and equipping of the well and each was to receive one-half of the net income.

Early in 1925 five producing gas wells were drilled. The following is the amount which the Land Company received out of the net income from the gas produced by said wells out of its one half divisional interest in the leasehold estate. This is in addition to what the Land Company received as lessor in the way of landowner's royalty of a 1/8. The following is the divisional interest income of the Land Company since 1925:

1925	$3,671.46
1926	1,489.95
1927	1,755.72
1928	1,762.70
	$8,679.83

Defendant's Exhibit B, pp. 8-9.

(During missing years field operated by trustee and figures are not available.)

1934	$ 667.98
1935	493.93
1936	348.61
1937	252.02
1938	210.17
1939	262.73
1940	269.34
1941	173.61
1942	104.95
1943	155.11
	$2,938.25

Defendant's Exhibit "A," pp. 3-12.

	$8,679.83
	2,938.25
Total	$11,618.08

ADDENDUM II

Production of Oil and Gas on All Leases

Year		Income Less Royalty	Minus Operating Costs	Income In Excess of Royalties and Operating Costs
1934	Gas	$ 4,225.95		
	Oil	* 3,000.00	$ 1,944.00	$ 5,281.95
1935	Gas	3,312.02		
	Oil	* 3,000.00	847.00	5,465.02
1936	Gas	2,757.45		
	Oil	* 2,800.00	783.00	4,774.45
1937	Gas	2,389.63		
	Oil	* 2,700.00	1,160.00	3,929.63
1938	Gas	2,087.29		
	Oil	2,691.14	2,216.00	2,562.43
1939	Gas	2,082.71		
	Oil	2,096.07	2,341.00	1,837.78
1940	Gas	2,032.96		
	Oil	1,932.04	2,992.00	973.00
1941	Gas	1,623.39		
	Oil	2,385.63	3,225.00	784.02
1942	Gas	910.02		
	Oil	3,627.18	3,474.00	1,063.20
1943	Gas	1,536.52		
	Oil	2,272.92	3,378.00	431.44
1944	Jan 1 to May 31:			
	Gas	767.44		
	Oil	842.97	1,448.00	162.41
Total	Gas	$23,725.38	$23,808.00	$27,265.33
	Oil	27,347.95		

Grand Total ---------- $51,073.33

(Defendant's Exhibit A, pp. 3-13 inclusive)

*As is shown in Defendant's Exhibit "C", page 3, defendant did not purchase or operate the oil wells and their production from A. W. Pausky until some time in the middle of 1937 and did not commence to operate these wells on the Hamilton-Swain tract and the other two leases that produced oil until about October, 1937. Consequently, A. W. Pausky's oil production for the first 4 years must be added. Even if the defendant did not own this production on the Hamilton-Swain lease in 1934, '35, '36, and '37, nevertheless, that income from such oil production necessarily must be considered if and when figuring whether the leases were producing oil or gas at a profit.

The exact oil production during the years just mentioned is not known but in 1938, according to the above schedule, the value of the oil production that year, after royalties were deducted, was $2,691.14. No new wells were drilled until October, November and December of 1941. It is common knowledge that production from shallow oil wells decreases each year. Between 1938 and 1939 these wells decreased in oil production to the value of $600 and between 1939 and 1940 approximately $150. Therefore an estimate that these wells produced in 1934 $3,000 worth of oil, the same in 1935 and 1936—$2800 and in 1937—$2700 less royalties is conservative.

Adding the royalties of 1/7 of all the gas produced the gross production of gas would be	$27,679.61
Adding royalties of 1/8 of all the oil produced the gross production of oil would be	$31,254.86
Grand total of	$58,934.47

ADDENDUM NO. III

The following are items of deductible expense listed in the Income Tax Reports of defendant from 1934 to and including 1943. These are deductible in an income tax report but are not operating costs under the decision of Garcia v. King (supra).

1934

Legal fees	$ 552.00
Office rent	180.00
Directors' fees	246.00
Accountant service	120.00

Franchise tax	21.60
Capital stock tax	15.00
Total	$1,134.60

1935

Directors' fees	$ 248.00
Accounting services	150.00
Legal fees	574.00
Office rent	180.00
Interest paid	20.00
Franchise tax	21.30
Capital stock tax	13.00
Depreciation	338.75
Total	$1,765.00

1936

Directors' fees	$ 138.00
Legal fees	385.00
Accounting fees	60.00
Interest paid	240.00
to Dallas Joint Stock Land Bank. This $240 is on the mortgage of the Voges fee of 136 acres.	
Promotion and stock sales exp.	110.00
Capital stock tax	10.00
Depreciation	303.75
Total	$1,273.75

1937

Legal fees	485.00
Accounting services	1.60
Interest	483.00
Promotion and stock sales exp.	26.50
Franchise tax	24.84
Capital stock tax	9.00
Traveling expenses	255.05
Depreciation	169.68
Total	$1,613.07

1938

Directors' fees	$ 170.00
Accounting and legal fees	555.00
Interest	578.24
Franchise tax	21.60
Capital stock tax	10.00
Traveling expense	139.65
Depreciation	205.00
Total	$1,679.49

1939

Directors' fee	$ 120.00
Legal and Traveling expenses	660.00
Accounting services	160.00
Interest expense	808.67
Franchise tax	21.00
Capital stock tax	9.00
Depreciation	678.71
And losses on leases and options (failure to exercise options)	$5,400.73
Total	$8,508.32

1940

Profit and loss statement missing from income tax report.

1941

Legal and supervision	$ 330.00
Interest expense	203.84
Professional fees	120.00
Sundry	27.37
Depreciation	825.91
Capital Stock tax	18.75
Franchise tax	48.30
Real Estate tax	75.76
Total	$1,649.93

1942

Legal expense	$ 185.00
Interest expense	371.71
Capital stock tax	1.25

State franchise tax	29.00
Professional fees	135.00
Travel	188.61
Depreciation	843.93
Total	$1,754.50

1943

Legal fees	151.00
Accounting	120.00
Interest	358.82
Depreciation	671.64
Total	$1,301.46
Grand Total	$20,680.02

ADDENDUM IV

Gas Production on All Leases

The following is the production of gas on all the leases deducting royalties from 1934 to March 31, 1944. These figures are taken from Appellant's Ex. "A," 1-13, blue pencil paging.

Year	Gross Income of Gas on All Leases	After Deductions of 1/7 Royalty
1934	$ 4,930.27	$ 4,225.95
1935	3,864.02	3,312.02
1936	3,217.02	2,757.45
1937	2,787.90	2,389.63
1938	2,435.17	2,087.29
1939	2,429.81	2,082.71
1940	2,410.28	2,032.96
1941	1,893.95	1,623.39
1942	1,061.67	910.02
1943	1,792.60	1,536.52
1944—		
5/31	893.35	767.44
Total	$27,718.35	$23,725.38

ADDENDUM V

Gas Production on Hamilton-Swain Lease

The following is the production of gas on the Hamilton-Swain lease, deducting royalties and taxes from 1934 to March 31, 1944. The figures are taken from Defendant's Exhibit C, pp. 4 to 9.

1934	$1,052.01	$ 901.87
1935	935.32	801.70
1936	738.06	632.62
1937	518.72	444.62
1938	422.23	361.91
1939	361.56	309.91
1940	374.40	320.92
1941	325.81	279.27
1942	194.26	167.94
1943	232.62	199.62
Total Jan., Feb., Mar. 1944-80.85		69.30
		$4,489.68
Total	$5,245.52	

ADDENDUM VI

Oil Income on Hamilton-Swain Lease

Gross Income of Oil on H-S Lease from Figures Taken from Defendant's Ex. C. pp. 4 to 9.

Oil Income After Deduction of Royalty and Production Tax

1934	$2,055.99
1935	1,905.99
1936	1.755.99
1937	1,605.99
1938	1,455.99
1939	919.22
1940	860.91
1941	1,136.90
Seven of the oil wells were brought in as producers the last months of 1941	
1942	2,388.63

Oil Income After Deduction of Royalty and Production Tax

1934	$1,142.74
1935	1,142.74
1936	1,142.74
1937	1,142.74
1938	1,142.74
1939	804.32
1940	753.30
1941	994.79
1942	2,090.05

Difference due to 7 new wells drilled. What a difference there would have been if defendant had been allowed to drill all 15 wells!

1943 ---------- 1,378.24 1943 ---------- 1,205.96

This decrease shows how refinery war troubles affected production as defendant could not produce more than refinery could truck away.

Total ----------$15,403.65 Total -------$11,562.12

Total Production on H-S ----------$15,403.65 Oil Production

5,245.74 Gas Production

$20,649.39 Total Oil & Gas

ADDENDUM VII

The following is the net income from oil and gas production on the Hamilton-Swain lease itself in excess of royalties and the operating cost of all the leases, when broken down to the Hamilton-Swain tract, first on the well basis and second, on an income basis.

Well Basis
Appellant's Brief, Pages 107 to 112

Year	Net Income
1934	$ 553.87
1935	649.70
1936	492.62
1937	367.36
1938	1,045.65
1939	629.27
1940	453.22
1941	515.62
1942	1,085.94
1943	326.62
Total	$6,119.97

Income Basis
Appellant's Brief, Pages 112-116

Year	Net Income
1934	$ 474.87
1935	689.61
1936	448.62

1937	575.36
1938	783.65
1939	468.27
1940	237.22
1941	332.62
1942	413.94
1943	88.62
Total	$4,512.78

Defendant's Exhibit "C", pp. 4-9.

ADDENDUM NO. VIII

The following are the two main paragraphs of that contract: (Defendant's Ex. 16½, Ex. Appendix, 59)

"1. The Land Company hereby releases the Development Company, its predecessor, successors or assigns, from the obligation to further develop said property, or any part thereof, for oil or gas, and hereby recognizes title in the Development Company, its successors or assigns, free from forfeiture, to all oil or gas wells drilled by said Development Company, its predecessors or assigns upon the above described property, except a one-half interest in certain gas wells thereon now owned by the Land Company.

"2. The Development Company hereby gives and grants unto the said Land Company, its successors or assigns, the right to drill wells for oil or gas upon any part of said property, and in the event production of either oil or gas in commercial quantities results therefrom, the Land Company will own such production, subject to payment to the Development Company of the royalties provided by said instrument of May 24, 1924, to-wit: one cent per thousand cubic feet of gas and one-eighth of oil; and further, in the event of such production, the Land Company, its successors or assigns. will have the sole right to further develop for oil or gas an area around the discovery well extending a distance of twenty-five hundred feet in every direction therefrom, subject to the obligation of the Land Company in such contingency to reasonably develop such area with reasonable diligence."

ADDENDUM NO. IX

Defendant's Exhibit 17, Exhibit Appendix 61.

"Assignment by the Hamilton Land & Development Company, by W. H. Kennon, president, to American Gas Company, dated March 30, 1932. Recorded April 1, 1932, in Vol. 1301, pp. 137-139, Bexar County Deed Records.

* * * *

"Whereas, thereafter said original instrument was by mutual agreement of the parties again modified to provide for the right in said Hamilton Land & Development Company, its successors or assigns to drill for oil or gas upon said premises and to own any production resulting therefrom, subject to the payment of a royalty to said Gas Ridge Development Company of one cent (1c) per thousand cubic feet of gas and one-eighth of the oil. The latter agreement is evidenced by authorization therefor in the minutes of said Land Company and copies of the contract entered into contained in its files; and

"Whereas, at the joint expense of said Hamilton Land & Development Company and said Gas Ridge Development Company, five certain gas wells were drilled upon said premises and are jointly owned by said companies; and

"Whereas, the Hamilton Land & Development Company has agreed to assign, convey and deliver each and all of its rights and privileges in said original lease and modifications, together with the five gas wells, subject to the overriding royalty to the Gas Ridge Development Company under the terms of the original and modified lease agreement:

"Now, therefore, in consideration of the premises and of $10.00 and other valuable considerations to it in hand paid, the Hamilton Land & Development Company does hereby assign, transfer, convey, and deliver unto the American Gas Company, its successors and assigns, each and every drilling right and privilege to which it may be entitled upon said above described premises, together with all the right, title and interest of grantor in and to said five gas wells, known as H. & S. Nos. 11, 12, 13, 14, and 15, and all of the right, title and interest of grantor as lessor in said original lease

and modifications, it being understood that this assignment is made expressly subject to the overriding royalties upon oil and gas to which said Gas Ridge Development Company may be entitled, and to the fee royalties payable to grantor under the terms of said original and modified lease agreements.

"As a part of the consideration hereof, said American Gas Company does hereby assume and agree to perform all of the obligations resting upon grantor under the provisions of any of the aforesaid instruments.

Hamilton Land & Development Company

By W. H. Kennon, President American Gas Company

By H. A. Pagenkopf, President